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TAGS: [EFIN](#) [PGOV](#) [ECON](#) [TW](#)
SUBJECT: MEGA CASE LEAVES FINANCIAL REFORM IN LIMBO

REF: A. 05 TAIPEI 4431

[1](#)B. 05 TAIPEI 4187

[1](#)C. TAIPEI 2266

Classified By: AIT Acting Deputy Director Charles E. Bennett, Reasons 1
.4 b/d

[1](#)1. (C) Summary: In late June, the Taiwan authorities negotiated a deal with private investors to retain control of the board of directors of Mega Holdings Co. While Vice Premier Tsai Ing-wen gained stature in the financial community and with the opposition by resolving the conflict, the controversy led to a new Finance Minister and restrictions on ChinaTrust, the bank that sought to takeover Mega. Financial sector reform, now stalled for many months, remains in limbo. End summary.

A Major Financial Asset for the Taiwan Authorities

[1](#)2. (U) Mega Holdings Co. is Taiwan's third largest of its 14 financial holding companies and has assets of NT\$ 2.2 trillion (US\$ 69 billion). It has five wholly-owned subsidiaries including the International Commercial Bank of China (ICBC, Taiwan's top foreign exchange trading bank), Chiao Tung (Transportation) Bank, Chung Kuo Insurance Co., Chung Hsing Bill Financing Co., and Bartis International Securities Co. The Taiwan authorities are the largest shareholders with a 22.5 percent stake controlled by the Ministry of Finance. ICBC and Chiao Tung are both state-owned banks. ChinaTrust Financial Holding Co., which is controlled by Taiwan's powerful Koo family, owns 15 percent of Mega's stock. In recent years, Taiwan has encouraged foreign institutional investors (FII) to buy into the island's financial institutions and now FIIs own about the same amount of Mega stock as do the authorities.

Public Outrage at Agreement to Surrender Control

[1](#)3. (U) Ministry of Finance officials met with ChinaTrust and other shareholders in May to discuss upcoming board elections. At the meeting, the authorities and private investors reached an understanding that in board elections scheduled for June 23, the authorities would chose 7 out of 15 directors and private investors would chose another 7 directors. The last director would be an "independent" director recommended by FIIs. They also agreed that Mega

Chairman Cheng Shen-chih would be re-elected.

¶4. (U) The deal generated heavy criticism from the media and the Pan-Blue opposition. Critics argued that as the largest shareholder, the authorities should maintain control of Mega's board. Opposition Pan-Blue legislators, who have consistently criticized the authorities' financial sector reform measures (refs A and B), called for Premier Su Tseng-chang to take responsibility for the flawed deal and for then Minister of Finance Joseph Lyu to resign. Lin Chuan, who was Finance Minister before Lyu took office in January 2006, also criticized the impending loss of control.

An Unusual Compromise

¶5. (U) In response to the criticism, Premier Su decided the authorities should retain control of the board and appointed Vice Premier Tsai to handle the situation. Mega's private investors had already secured the proxy votes they needed to elect the seats they wanted on the board. However, the two sides were able to reach a new agreement.

¶6. (U) Under the compromise arrangement, 15 directors were elected on June 23. Private sector candidates and candidates named by the authorities each took seven seats. Former Vice Premier Wu Rong-I took the remaining seat as an independent director. The board re-elected Cheng as Chairman. However, immediately after the board meeting, one of the private sector directors, Chieh Hung-wen (Chairman of Bartis International Securities), and Wu resigned from the board. This restored control to the Taiwan authorities with a 7-6 majority on the board.

¶7. (C) Vice Premier Tsai told AIT/T on June 29 that she was satisfied with the compromise outcome, though not pleased with the process. She said certain people were simply not doing their jobs and it turned out that she had to go and do their jobs for them. The implication was that Finance Minister Lyu was at fault. In a 10:30 PM press conference June 29, Premier Su fired Lyu by reassigning him and appointing an academic, Ho Chih-chin, from National Taiwan University as the new finance minister (see ref C). Ruling party Democratic Progressive Party (DPP) legislators publicly criticized Su for not consulting with them prior to the announcement, and for appointing an academic with no administrative experience in Taiwan.

¶8. (C) In a major political victory, Tsai also noted that opposition lawmakers called to congratulate her after the announcement, saying that in light of this positive result by the authorities, the opposition would not be pursuing a no-confidence vote against Premier Su's cabinet at this time. Tsai was clearly pleased with the gesture from the opposition, but emphasized the KMT's stance on a no-confidence vote could be reviewed at any time.

Backlash against ChinaTrust

¶9. (U) After the board elections were resolved, Taiwan's Financial Supervisory Commission (FSC) chastised ChinaTrust. To reduce the cost of its investment in Mega, ChinaTrust had purchased in Hong Kong a US\$ 390 million package of securities that were primarily derivatives linked to Mega stocks prior to increasing its stake in the firm. Although technically legal, FSC criticized the move as risky and instructed ChinaTrust to improve its risk management. FSC suspended its review of ChinaTrust's applications to set up overseas offices and froze approval of its investment applications.

¶10. (C) On July 3, FSC Director of International Affairs Mr. Andrea Lee told AIT/T that FSC's action should not be viewed as a punishment for ChinaTrust. He noted that no

finances were imposed or individuals singled out for punishment. He said FSC merely delayed adjudication of ChinaTrust applications for overseas offices and for new investments for an indefinite period. Lee also said the FSC action was not taken in retaliation for ChinaTrust's actions in the Mega Director's meetings. He emphasized that FSC believes ChinaTrust skirted the rules by not declaring its additional equity holdings in Mega and therefore FSC needed to assert its regulatory power to oversee ChinaTrust activities.

Financial Sector Reform Remains in Limbo

¶11. (C) Comment: The Mega Financial controversy will continue to have repercussions for the Chen administration and financial reform efforts. In the near term, the authorities have stopped further sales of shares in 12 state-owned financial institutions, further delaying efforts to privatize state-run banks and reduce the number of state-run financial holding companies. Such sales may resume after the Economic Sustainable Development Conference July 27-28 takes up discussion on financial issues. More importantly, the controversy gives fuel to critics who had already been arguing the administration's financial reform program favors selected Taiwan financial tycoons with below-market sales of state assets. On the positive side, observers and analysts also told AIT/T this episode reaffirms the Vice Premier's high standing on economic issues. She is viewed as having adroitly handled a messy financial situation and taken decisive action that makes the authorities look good. End comment.
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